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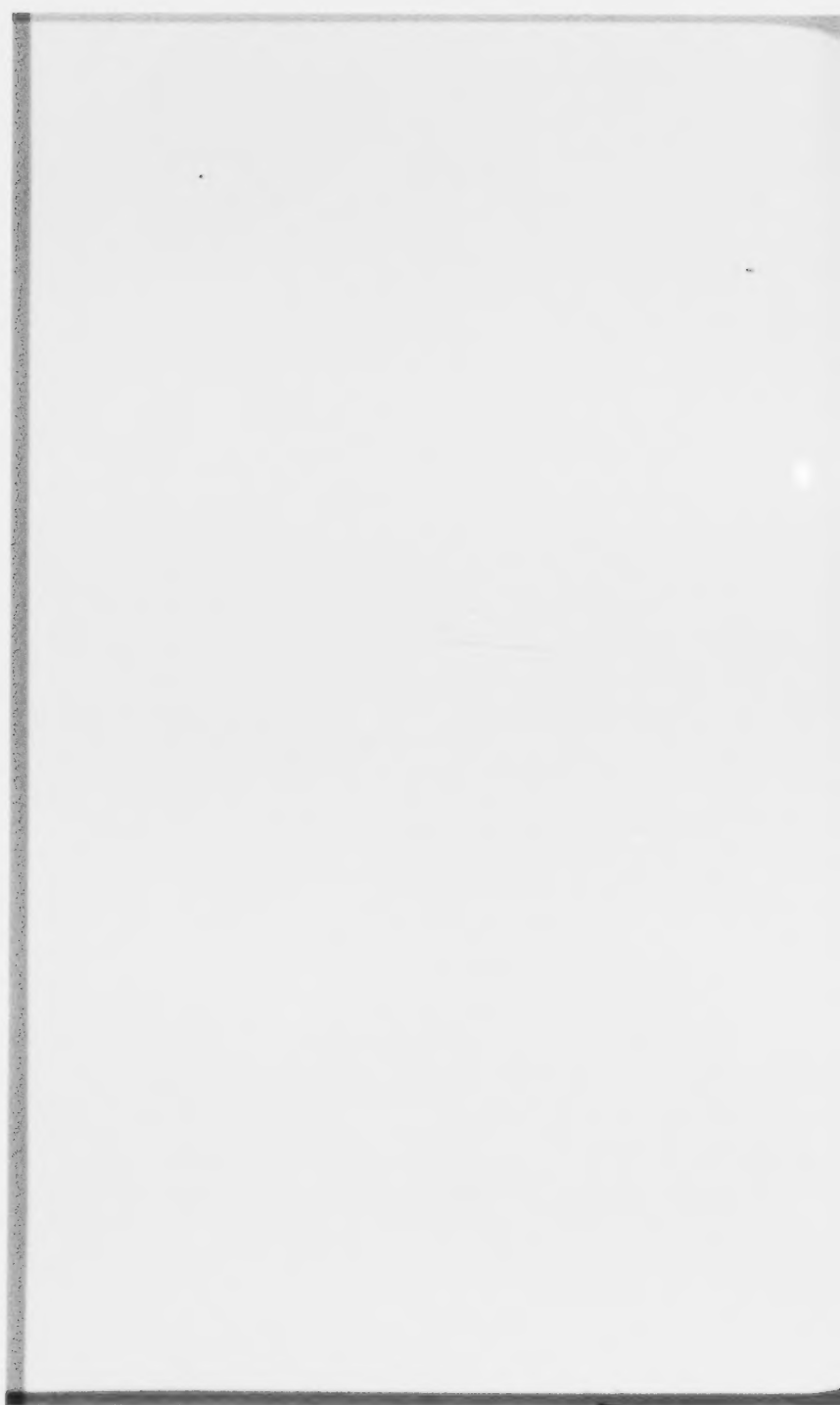
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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1176

L. W. MESTA, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE THIRD
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 3-14) is reported in 42 B. T. A. 933. The opinion of the Circuit Court of Appeals (R. 32-36) is reported in 123 F. (2d) 986.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 25, 1941 (R. 37). The time within which to file a petition for a writ of certiorari was extended to April 25, 1942, by order of

this Court entered February 11, 1942 (R. 38). The petition for a writ of certiorari was filed April 25, 1942. Jurisdiction of this Court is invoked under section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether petitioner realized income by the transfer of stock to his wife, pursuant to an agreement made in anticipation of divorce, when the stock had a market value at the time of the transfer in excess of its basis in the hands of petitioner.

STATUTES AND REGULATIONS INVOLVED

The relevant statutory provisions and regulations are set forth in the Appendix, *infra*, pp. 11-14.

STATEMENT

The facts may be summarized as follows from the stipulation of the parties before the Board:

On February 14, 1935, petitioner's wife, Cora Jane Mesta, filed a libel of divorce against petitioner in the Court of Common Pleas of Allegheny County, Pennsylvania, praying for a divorce from bed and board and for alimony. On March 8, 1935, Mrs. Mesta amended her libel to ask for an absolute divorce (R. 18). On March 22, 1935, petitioner signed an agreement providing for the transfer to his wife of 5,200 shares of common stock of the Mesta Machine Company together with dividends on the stock declared or paid after March 6, 1935

(R. 18, 22, Ex. E). The agreement further provided that both petitioner and Mrs. Mesta waived any claims or rights either might have against the other's property or estate growing out of the relationship of husband and wife, and that the property to be conveyed to Mrs. Mesta was in full satisfaction of all her claims for maintenance and support (R. 23, Ex. E). This agreement was then delivered to Mrs. Mesta's attorney and was signed by her on April 13, 1935 (R. 18). On April 15, 1935, the state court entered a decree granting her an absolute divorce from petitioner (R. 18). On April 17, 1935, the stock was transferred to Mrs. Mesta (R. 19). The 5,200 shares had a fair market value on that date of \$156,975; their cost to petitioner had been \$7,574.56 (R. 19).

Petitioner filed a gift-tax return and paid a tax upon the transfer of the stock (R. 20). Subsequently he filed a claim for refund, and the gift tax paid was refunded to him, with interest (R. 20, 27, Ex. G). Petitioner advised the collector of internal revenue to whom he had paid the tax that he accepted the refund without prejudice to his rights in the present proceeding, which was then pending before the Board of Tax Appeals (R. 20, 28, Ex. I, R. 30, Ex. K). The Commissioner determined that petitioner in 1935 had realized a capital gain of \$149,400.44, the difference between the cost of the stock and its fair market value at the time of transfer; accordingly, he determined

a deficiency in income tax of \$31,163.18 (R. 3). This determination was reversed by the Board of Tax Appeals, which held that no gain had been realized (R. 15). The decision of the Board was reversed by the Circuit Court of Appeals¹ (R. 37).

ARGUMENT

1. When petitioner transferred the 5,200 shares of Mesta Machine Company stock to his wife on April 17, 1935, he was discharging the obligation of his agreement with Mrs. Mesta made four days earlier. While under the law of Pennsylvania permanent alimony may be awarded only in the case of a divorce from bed and board,² an agreement providing for the support of a wife after absolute divorce will be enforced. See *Glendinning v. Commissioner*, 97 F. (2d) 51 (C. C. A. 3). In discharging his obligation to Mrs. Mesta, petitioner disposed of property which had a basis in his hands much lower than the value of the property when transferred. Since the parties were dealing at arm's length in making the agreement, it can only be supposed that Mrs. Mesta was relinquishing her rights in return for the contemporary value of the

¹ Two judges dissented. The case was first argued before three judges; the court on its own motion ordered a reargument before all five judges *en banc*.

² *Moore v. Moore*, 64 Pa. Super. 192; see Pa. Stat. Ann. (Purdon, 1930), title 23, secs. 46, 47; *Dixon v. Commissioner*, 109 F. (2d) 984, 986 (C. C. A. 3). An exception is made in the case of absolute divorce where the respondent is insane; permanent alimony may then be awarded. Pa. Stat. Ann. (Purdon, 1930), title 23, sec. 45.

stock as income-producing property.³ As the court below stated (R. 36), the practical assumption is warranted "that a man who spends money or gives property of a fixed value for an unliquidated claim is getting his money's worth."⁴ Accordingly, petitioner satisfied a contractual obligation owed to his wife with stock which had cost him much less than the amount of the claim being extinguished, and he realized gain to the extent of the difference. *Suisman v. Eaton*, 15 F. Supp. 113 (D. Conn.), affirmed *per curiam*, 83 F. (2d) 1019 (C. C. A. 2), certiorari denied, 299 U. S. 573; *Keenan v. Commissioner*, 114 F. (2d) 217 (C. C. A. 2); cf. *United States v. Kirby Lumber Co.*, 284 U. S. 1.⁵

³ While it is true that Mrs. Mesta's amendment of her libel, asking an absolute rather than a limited divorce, antedated the agreement with petitioner, the amendment clearly should not be regarded as unrelated to the agreement, since the wife would be financially protected under the state law in case of absolute divorce only by virtue of an extra-judicial settlement (see page 4, *supra*); with such a settlement in prospect, she could safely amend the libel. See R. 34 (opinion below).

Mrs. Mesta's basis for the stock on her disposition of it would be its fair market value at the time of acquisition in April 1935. Cf. *Sherman Ewing*, 40 B. T. A. 912.

⁴ The soundness of this proposition in the particular case is reflected in the stipulation of the parties (R. 19) that petitioner on April 13, 1935, owned personal property worth approximately \$1,150,000.

⁵ As this Court has stated, the transfer of stock outright by a husband to his wife as part of a property settlement in divorce does not differ from the situation "where any debtor * * * transfers securities * * * to his creditor in whole or partial payment of his debt." *Helvering v. Fuller*, 310 U. S. 69, 74.

2. There is no conflict of decisions, since no other circuit court of appeals or the Court of Claims has passed on the question involved in the present case.⁶ Petitioner does not contend otherwise, but alleges (Pet. 9-10) "conflict in principle" between the decision below and *Helvering v. United States Trust Co.*, 111 F. (2d) 576 (C. C. A. 2), certiorari denied, 311 U. S. 678; *Commissioner v. Greene*, 119 F. (2d) 383 (C. C. A. 9), certiorari denied, 314 U. S. 641; and *Commissioner v. Bristol*, 121 F. (2d) 129 (C. C. A. 1). In the *United States Trust Co.* case the court held that a wife's surrender of her right to support in return for her husband's creating a trust fund for her pursuant to an agreement made prior to divorce was a "relinquishment * * * of * * * marital rights in the decedent's property or estate" within the meaning of section 804 of the Revenue Act of 1932, so that the transfer in trust was not for a consideration "in money or money's worth" under another section, exempting from estate tax. In the *Bristol* case a comparable *antenuptial* transfer, in return for surrender of the wife's statutory rights in other property owned by the husband, was held subject to gift tax as not having been made for a consideration "in money or money's worth" by analogy to the estate-

⁶ The same question has been raised in *Walter S. Halliwell*, 44 B. T. A. 740, now pending on appeal to the Circuit Court of Appeals for the Second Circuit. The Board there followed its decision herein.

tax law. Petitioner has contended that his transfer to Mrs. Mesta in 1935 was a marriage settlement under Article 22 (b) (3)-1 of Regulations 86 and therefore constituted a gift (C. C. A. Br. 20-21); the court below stated the contrary (R. 36), and petitioner alleges that the decision therefore conflicts in principle with the holdings that surrender of marital rights is not full and adequate consideration in money or money's worth.

Argument is unnecessary that the transfer was not a marriage settlement, for purposes of the income tax. See 2 Bouvier, Law Dictionary (1897) 320. Further, none of the cases cited by petitioner as conflicting hold that a divorce settlement (made in consideration of a surrender of the right to support) is a gift, for purposes of the gift tax law.⁷ Such a result may be implicit in the *United States Trust Co.* and *Bristol* cases, taken together, but it

⁷ Petitioner states (Pet. 7) "that the Gift Tax Unit of the Bureau of Internal Revenue is now closing transactions of this character by the imposition of a gift tax and that at the same time the Income Tax Unit of the same Bureau, is imposing an income tax liability in other but similar cases." The Bureau of Internal Revenue has advised that the Miscellaneous Tax Unit, which administers the gift tax, has taken the position that divorce settlements do not effect gifts to the extent that the settlements are made in satisfaction of an obligation to support spouse and children. However, the Unit rules that relinquishment of dower or statutory rights in lieu of dower is not full and adequate consideration in money or money's worth, and property transferred in return for such relinquishment is held taxable as a gift.

would clearly not exclude the imposition of income tax on the transferor where he realizes gain from the disposition of property in discharging an obligation. The gift and income taxes are separate legislation; Congress may well have provided that a transaction which happens to give rise to income under one law results in transfer-tax liability under the other pursuant to an exemption provision which excludes transfers for less than full pecuniary consideration (such as surrender of the right to support). *Commissioner v. Greene, supra*, cited by petitioner as conflicting, merely holds that money paid from the estate of an incompetent, pursuant to the distribution order of a probate court, for support of the incompetent's adult daughters is subject to gift tax because of lack of consideration for the transfer. It is plain from what has been said above that the decision of the court below, on income tax, presents no conflict with any of the three cases advanced by petitioner, involving other taxes.

3. Petitioner also contends that he realized no gain in the transfer to Mrs. Mesta because he received nothing of exchangeable value in return.*

* *Hirsch v. Commissioner*, 115 F. (2d) 656 (C. C. A. 7), is cited in the petition as conflicting (Pet. 11). The opinion there contains a statement supporting petitioner (115 F. (2d) at 657), but the holding is not in point. A purchaser had arranged to acquire real estate for a cash payment and the

Obviously such receipt is unnecessary. *Suisman v. Eaton, supra*; *Kenan v. Commissioner, supra*; cf. *Helvering v. Horst*, 311 U. S. 112. In support of its decision the court below quoted (R. 35) a statement from the opinion in the *Horst* case: "Where the taxpayer does not receive payment of income in money or property realization may occur when the last step is taken by which he obtains the fruition of the economic gain which has already accrued to him" (311 U. S. at 115).

Petitioner states that the Circuit Court of Appeals has extended the rule of *Helvering v. Horst, supra*, to the case of a transfer of income-producing property, and asserts that since the question of the outer extent of the rule's applicability was reserved by the Court in *Harrison v. Schaffner*, 312 U. S. 579, 583-584, the decision below should be reviewed (Pet. 12). The argument would have merit only if the Commissioner had attempted to tax the dividends received by petitioner's wife on the Mesta Machine Company stock after the transfer.

assumption of a mortgage; after the property had declined greatly in value, the purchaser secured a release from the mortgage debt by payment of less than its face amount. The court held that the purchaser had not realized gain, that the release constituted only a reduction in purchase price, and that its income-tax consequences should not be assessed until the taxpayer disposed of the real estate, when the economic result of the whole transaction would be known. Cf. *Bowers v. Kerbaugh-Emper Co.*, 271 U. S. 170.

CONCLUSION

The judgment below is correct, and presents no conflict of decisions. It is therefore respectfully submitted that the petition should be denied.

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